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Japanese Urban Land Prices: A Continuing Drag on the Economy

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Summary

A decline since late 1987 in the exorbitant price of urban land has lessened the pressure on Prime Minister Takeshita to seek fundamental tax and zoning law reforms aimed at stemming the perennial upward pressure on real estate prices, but the burden of expensive land will continue to constrain economic growth. The profit that many Japanese make from the current system is the primary block to change, but Takeshita sees political benefits--namely buttressing urban support for the ruling party--from at least paying lipservice to land reform. Thus, he could be compelled to take a more active hand in the issue if speculative or other pressures drive up real estate prices again.

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This memorandum was prepared by Office of East Asian Analysis. Information available as of 11 May 1988 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Japan Branch, Northeast Asia Division, OEA

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The Land Price Runup: Costs to the Japanese Economy

High urban land prices have been a fact of Japanese life since at least the early 1970s, but the sharp rises of the past three years have shocked even the Japanese. With one-fourth of Japan's population and one-third of its wealth, Tokyo has had the worst recent bouts of land price inflation. Prices there rose over 20 percent in 1986, and almost 70 percent in 1987, with much higher increases in key business districts. The media cited speculation and, as a swipe at foreigners, the movement of foreign firms into Tokyo, as the major causes. Other cities had lower price hikes, but these still disturbed potential homeowners and businesses. In any case, newspaper polls proved that attention paid by the Tokyo-based national press made land prices a major public concern. [REDACTED]

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For Japanese policymakers, the land price issue was not new. Both US and OECD officials have repeatedly pointed out to their Japanese counterparts the economic ills caused by these sky-high real estate costs:

- High land prices reduce private consumption--of both imports and domestic goods. Businessmen, in turn, ratchet up prices for goods and services, further depressing consumption, in their attempt to cover higher outlays for their own property.
- Land costs also have contributed to Japan's high savings rate, identified by most economists as a major factor in the country's massive current account surpluses. Because a house within commuting distance of Tokyo costs the equivalent of 9 years' income--compared with 3.3 years' income for an American buying in the New York area--Japanese must save an enormous amount to make a down payment.
- Fiscal policy choices, already limited in an era of tight Japanese national budgets, are also curbed by real estate costs. Government efforts to stimulate growth through public works spending, for example, are undermined by the necessity to devote a high percentage of the public works budget to buying land. [REDACTED]

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Tokyo's Response

Probably because it had successfully weathered similar price runups in 1961 and in 1972-73 (see inset), the government was slow to act in 1985-86. In our view, its response was also largely ineffectual.

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- Beginning in 1986, the National Land Agency, which coordinates land policy for the Prime Minister's office, imposed price monitoring designed to minimize speculation on land sales--first of 500-, then 300-, and finally 100-square-meter plots. The measure, based only on moral suasion, had little effect at a time when enormous profits could be gained.
- A government-imposed freeze on the sale of public lands backfired. Government officials assumed that keeping land off the market would decrease speculation. Instead, by curbing supply, the measure only contributed to land scarcity.

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Fears about the consequences of land price speculation on the part of financial analysts, as well as government officials, appeared by mid-1987 to bring a sharp change in Tokyo's behavior. Essentially, concern that real estate inflation was feeding the overheated stock market--and that the dynamic could lead to a crash of one or both--drove the government to act more forcefully. Specifically, the Finance Ministry instructed banks to curb real estate lending in summer 1987. The intent was to cut back on the ability of speculators to purchase stock on margin, using the collateral of overvalued real estate financed by bank loans. The combination of firm government action and the mid-October stock market drop dramatically reduced speculative real estate activity, reflected in fourth-quarter 1987 land prices, which fell about 3 percent in the major cities.

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And Now?

Notwithstanding the recent decline in land prices, officials in Tokyo are still afraid that projected brisk economic growth may reignite real estate inflation. Thus, the National Land Agency has left its price monitoring system in place, and the Finance Ministry probably will continue to keep a close eye on real estate lending. Ruling party and government leaders also are moving to implement tax reforms in 1988--and to propose others that will weaken the incentive to hold land:

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- The new law eliminates an exemption from the capital gains tax for profits from land used to purchase residential real estate of higher value. It should help reduce pressure to bid up prices.
- The current steeply progressive tax on sales of land held 5 years or more also will be altered to a straight 26-percent withholding tax. This should increase the availability of land by making it more attractive to sell.
- Finally, tax reform appears likely to lower the top income tax rate, probably to around 50 percent. The proposal is due for debate later this year. If adopted, it will reduce the tax bite on real estate sales. []

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Other official steps are under way that should help the land price problem. Land reclamation and regional development projects, spurred in part by Tokyo's \$48 billion fiscal stimulation program, should dampen speculation in the city centers. Many of the projects, such as development of the coastal areas of Tokyo and Osaka, are termed "regional," although they actually represent expansions of existing urban areas. []

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Eventually, in our view, the Land Agency will have to release more public land for sale. The first such action--sales of land formerly owned by the now-privatized national railroad--will make available some prime real estate in and outside Tokyo. []

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The Long Term: Making a Difficult Situation Worse

Even if Tokyo successfully stabilizes land prices, there are likely to be few benefits for the average Japanese. Most important, home ownership is likely to remain well out of reach for many new families.¹ The difficulty of finding housing obviously stems in large part from Japan's geography and dense population which put pressure on land prices. But the large number of small plots makes it difficult and expensive to assemble blocks of land for development, and government policies continue to exacerbate the situation, especially on the supply side:

- 178,000 acres in the three largest cities are still designated as agricultural land and accorded special tax protections, being assessed at a fraction of the rate of other urban land and exempt from onerous inheritance taxes, if held 20 years.
- For other land, tax policy also promotes holding, rather than developing, real estate--for example for new housing. For urban property, the tax runs at about 1.4 percent of assessed values, which may, in turn, be as little as one-third or one-quarter of market values. The result makes it prudent to avoid steps, such as construction, which could push up assessments and taxes.

¹ A recent newspaper poll indicated that over 40 percent of Japanese have given up hope of ever owning their own homes because of the high cost. []

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- Zoning laws thwart intensive land development, for example, by forcing builders to obtain the permission of surrounding residents whose access to sunlight would be blocked. This process is expensive, especially for developers of high-rise buildings with the potential to intensify land use. []

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Government policy also exacerbates competition for--and therefore the price of--residential housing by encouraging demand via subsidies for low-cost mortgages and rental construction. For example, interest rates on government-subsidized mortgages are sometimes as much as 3 percentage points below market rates. []

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The Politics of Land Reform: The Real Key

Notwithstanding the political payoff for a Japanese leader who could make more affordable housing available, successive administrations have not actively sought to alter the present system. A major factor in their behavior, in our view, is suggested by opinion sampling that shows a substantial number of Japanese who already own land believe they benefit from the current system. For example, roughly 44 percent of the population prefers to see prices either stay the same or rise, according to a recent newspaper poll. Opposition to change in land policies from other quarters also is important. The powerful agriculture sector opposes removal of protections from urban agricultural land, believing such a step would lead to more general agricultural reform and hurt its interests. []

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To avoid political opposition, the plans advanced by the Land Agency to encourage more efficient real estate development have taken the path of least resistance, focusing on territory outside Tokyo and the other major cities rather than on urban centers. Ironically, two of the Land Agency's first three plans in the 1960s actually contributed to Tokyo's growth by fostering suburban centers and a mass transit system around the capital. The implications of the Land Agency's approach have not been lost on the media. A recent press article referred to its policies as a "painted rice cake"--in other words, one that cannot be eaten--because they have failed to address the fundamental problems of too much protection for too many urban landholders. []

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Prime Minister Takeshita's own scheme to develop "hometowns," regional centers where more Japanese could live and work, closely parallels Land Agency policies. As he articulated in his preelection platform late last year, Takeshita advocates reducing Japan's economic dependence on Tokyo to solve overcrowding and inadequate housing and to develop the hinterland. His proposals appeal to voters in both urban and rural areas; they artfully avoid offending interest groups, and offer significant pork barrel opportunities. []

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Takeshita's land development--although not fundamentally reforming urban landholding patterns--could help make Tokyo a more livable city. Ideally, its approach would allow people to work in other, more attractive locales where an infusion of government capital would promote construction. Not surprisingly, such regional

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development and land reclamation projects would provide lucrative opportunities for the construction industry--a key Takeshita support group--and perhaps take some of the sting out of agricultural market liberalization for rural interests, another important constituency. [REDACTED]

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Little Relief in Sight

Whatever the success of Takeshita's "hometown" plan--we doubt it will cause a long-term downswing in prices, in Tokyo or elsewhere. Japan's move to a service-oriented economy is certain to further spur business concentration in cities as companies strive to be near the centers of power and information. Indeed, neither Tanaka's archipelago scheme, the Trade Ministry's 1983 Technopolis program to form regional technology centers, nor the Tsukuba Science City have been particularly successful in luring people and businesses from the major metropolitan areas. In addition, government ministries will be slow to accept Takeshita's attempt to get the ball rolling by pushing the bureaucracy to move some functions outside Tokyo. [REDACTED]

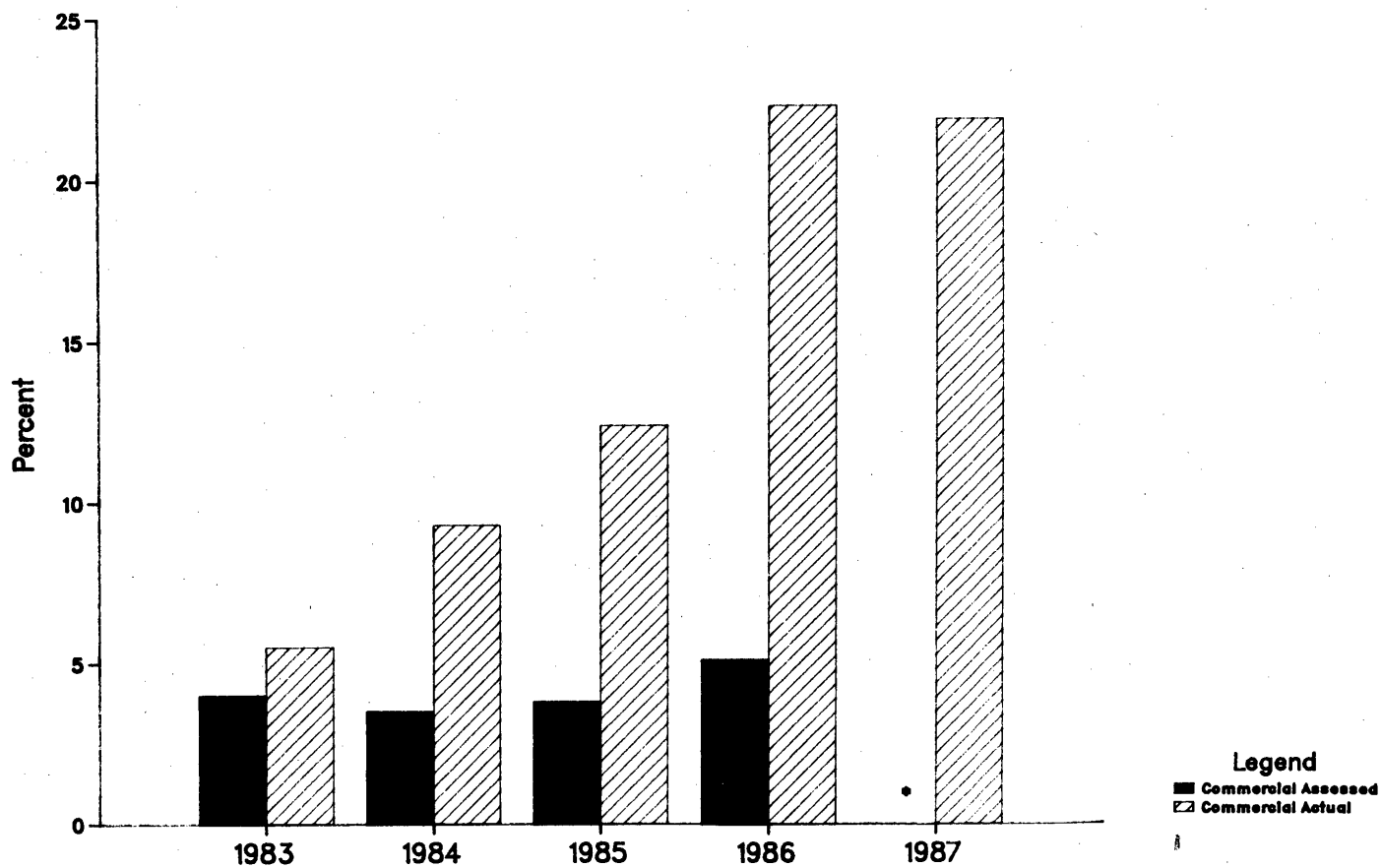
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Only a decision by the ruling party to strike at the heart of the urban problem by removing the tax advantages enjoyed by landholders will help expand urban land supply, in our view. Given the risk of alienating voters, we doubt Takeshita is ready to take this step. The Prime Minister may tout his hometown message to garner support in the next general election, but we doubt he will push any fundamental reforms. In addition, having just made agricultural trade concessions to Washington, he will be slow to further alienate agricultural interests, especially if land prices remain stable. [REDACTED]

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Japan: Land Price Inflation



*1987 Data not available.

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